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FISCAL IMPACT STATEMENT

LS 7113

BILL NUMBER: HB 1332

NOTE PREPARED: Jan 10, 2006

BILL AMENDED:

SUBJECT: Alternative Fuel Production and Use.

FIRST AUTHOR: Rep. Friend

BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides for a deduction against property taxes for organic biomass conversion units and coal conversion systems.

The bill provides that a taxpayer who owns a hybrid vehicle is entitled to an income tax deduction equal to the lesser of \$1,000 or \$85 per month for each month the taxpayer owns the hybrid vehicle.

The bill increases the maximum amount of credits that may be granted for biodiesel production, biodiesel blending, and ethanol production. It also extends the tax credit for the retail sale of blended biodiesel to 2010, and eliminates the cap on the maximum amount of credits that may be given.

The bill grants a credit for installing or retrofitting a fuel station to dispense E85 base fuel. It reduces the gasoline tax on E85 base fuel to \$0.128 tax rate per gallon. It also grants a credit against excise tax that otherwise would be imposed on a vehicle capable of using E85 base fuel.

The bill extends the tax credit for integrated coal gasification powerplants to coal gasification facilities as nonutility boilers or polygeneration. It also makes other related changes.

Effective Date: January 1, 2005 (retroactive); January 1, 2006 (retroactive); March 1, 2006 (retroactive); July 1, 2006; January 1, 2007.

Explanation of State Expenditures: *The Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to

incorporate the hybrid vehicle deduction, the tax credit for fueling station investment, and changes to the coal gasification technology investment credit. The DOR also is required to collect recapture taxes from taxpayers receiving refueling station investment credits who convert the property to other uses within three years of receiving the credits. The DOR's current level of resources should be sufficient to implement these administrative tasks.

Explanation of State Revenues: *Hybrid Vehicle Deduction:* The bill establishes a deduction from Adjusted Gross Income (AGI) for individual and corporate taxpayers that own hybrid vehicles. This deduction could potentially reduce AGI tax revenue by \$326,000 in FY 2008, with the revenue loss forecast to grow by an average of about 40% per year for five to six years thereafter.

Biodiesel/Ethanol Tax Credits: The bill makes changes to existing tax credits for production of ethanol, biodiesel, and blended biodiesel, and for retail sales of blended biodiesel. The changes are as follows:

(1) The bill increases the aggregate credit limit from \$20 M to \$50 M for the ethanol production, biodiesel production, and blended biodiesel production credits. The new aggregate limit would apply to all credits provided after December 31, 2004.

(2) The bill increases the taxpayer limits for the ethanol, biodiesel, and blended biodiesel production credits from \$3 M to \$4 M. In addition, the bill provides that the IEDC may increase the \$4 M taxpayer limit to a maximum of \$20 M for the ethanol, biodiesel, or blended biodiesel production credits to a taxpayer. Current law allows the IEDC to raise the maximum to \$5 M, but only for the ethanol and biodiesel production credits. The amount of additional credits that may be claimed due to the changes in (1) and (2) above is indeterminable and depends on IEDC certification of companies for the production credits. The IEDC certified \$12 M in ethanol production credits in 2005 for four companies, with each company receiving \$3 M in credits. No more ethanol production credits may be certified under current statute. With the new credit limits, the companies already certified for ethanol production credits could receive at least \$1 M each (a total of \$4 M in additional credits), and the IEDC could increase credits to these companies by up to \$30 M. The IEDC has not certified any credits for biodiesel or blended biodiesel production.

(3) The bill moves the sunset date for the blended biodiesel retail sales credit from December 31, 2006, to December 31, 2010. The bill also eliminates the \$1 M credit limit applicable to all taxpayers and all taxable years. The additional credits that might be claimed due both to extending the time frame of the credit and eliminating the credit limit is indeterminable and depends on IEDC certification of sales credits. In 2005, the IEDC did not certify any credits for the retail sale of blended biodiesel.

Fueling Station Investment Credits: The bill establishes a nonrefundable Adjusted Gross Income (AGI) Tax credit for qualified investment in fueling station property in Indiana delivers E85 base fuel directly into the fuel system of a motor vehicle used to operate the motor vehicle. The fueling station includes metered pumps, connected storage tanks for the metered pumps, piping, specified site improvements and equipment, and signage. The tax credit is effective for purchase, delivery, installation, and refitting expenses incurred after June 30, 2006, and before January 1, 2011. The property also must be placed in service prior to January 1, 2011, to qualify for the credit. The bill also provides for a clawback of the tax credit if the creditable fueling station property is converted to another use. The amount of fueling station investment credits that may be awarded is indeterminable, and the bill does not place an aggregate limit on credits that may be claimed.

Coal Gasification Technology Investment Tax Credit: The bill extends the tax credit to investment in a newly

constructed nonutility synthetic gas boiler or a polygeneration facility whether for utility or nonutility use. This change could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, the Financial Institutions Tax, the Insurance Premiums Tax, and the Utility Receipts Tax when a taxpayer undertakes qualified investment in such facilities. The potential amount of tax credits that may be granted as a result of the bill is indeterminable and will depend upon review and approval of creditable investment by the IEDC; and determinations by the IURC that the public convenience and necessity requires the construction of the nonutility synthetic gas boiler or a polygeneration facility.

Gasoline Tax: The bill provides for a reduced gasoline tax rate (\$0.128 per gallon instead of \$0.18 per gallon) on E85 base fuel effective for billed gallonage received in Indiana after June 30, 2006. As current and future E85 usage is unknown, the revenue loss from this rate reduction is indeterminable. However, the would reduce gasoline tax revenue by \$0.052 per gallon of E85 used, assuming each gallon of E85 substitutes for a gallon of gasoline that would otherwise be used.

The funds affected by a reduction in gasoline tax revenue are the State Highway Road Construction and Improvement Fund (SHRCIF), State Highway Fund, Motor Vehicle Highway Account (MVHA), and the Highway, Road, and Street Fund (HRSF).

Motor Vehicle Excise Tax: The bill provides a credit against the Motor Vehicle Excise Tax to an owner of a passenger vehicle or truck that is: (1) designed and equipped by the manufacturer to use E85 base fuel and first offered for sale after June 30, 2006; or (2) is converted to use E85 base fuel after June 30, 2006. The credit is equal to the tax amount that would otherwise be imposed for the first year or part of a year that the vehicle is subject to the tax. To the extent that E85 passenger cars and trucks replace conventional motor vehicles, there could be a reduction in Motor Vehicle Excise Tax revenue of an indeterminable amount.

State Property Tax: The bill establishes annual AV deductions for "organic waste biomass conversion units" and "coal conversion systems." (Definitions for these terms are provided below under Explanation of Local Revenues.) Property tax deductions exclude property from the property tax base. The state levies a small tax rate for the State Fair and State Forestry Funds that applies to all AV. If property is not a part of the tax base, the state cannot assess this tax on the property. Any decrease in the AV base as a result of deductions reduces the property tax revenue collected for these two funds.

Background: Hybrid Vehicle Deduction: The bill establishes a deduction from Adjusted Gross Income (AGI) for individual and corporate taxpayers owning hybrid vehicles. The deduction is equal to \$1,000 per hybrid vehicle owned by the taxpayer during the taxable year. The bill provides for a prorated amount if the vehicle is owned for fewer than 12 months during the taxable year. In addition, the bill disallows the deduction if the vehicle was purchased for the purpose of resale. The bill defines a "hybrid vehicle" as a motor vehicle that: (1) draws propulsion energy from both an internal combustion engine and an energy storage device; and (2) uses a regenerative braking system to recover waste energy to charge the energy storage device that is providing propulsion energy.

The estimated revenue impact is based on: (1) 2003 actual registrations of hybrid vehicles reported for Indiana; and (2) estimated annual growth rates in the number of hybrid vehicles in use through 2011. The annual growth rates described in (2), above, are derived from actual and forecast annual hybrid vehicle sales totals for the period 2000 to 2011, and assume vehicles are utilized for nine years on average. According to survey estimates by R. L. Polk, hybrid vehicle registrations in Indiana totaled 571 in 2003. The Office for the Study of Automotive Transportation is currently forecasting 2011 sales of about 1.3 million units nationally, up from

88,000 units in 2004 and 9,000 units in 2000. R. L. Polk survey estimates also suggest that the median age of cars in the U.S. is currently about 9.1 years, up from 8.9 years in 2004 and 8.3 years in 2000. The estimated deduction amounts assume a blended tax rate of about 4.7%, assuming about 75% of the impact will be from individual filers.

Biodiesel/Ethanol Tax Credits: Current statute provides credits against a taxpayer's Sales and Use Tax, AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for the production of biodiesel, blended biodiesel, and ethanol, and for the retail sale of blended biodiesel. The tax credits are: (1) \$1.00 for each gallon of biodiesel manufactured in Indiana and used to produce blended biodiesel; (2) \$0.02 per gallon of blended biodiesel produced in Indiana using biodiesel produced in Indiana; (3) \$0.125 per gallon of ethanol produced at an eligible facility in Indiana; and (4) \$0.01 per gallon of blended biodiesel sold by Indiana retailers.

Current statute limits the ethanol, biodiesel, and blended biodiesel production credits combined to \$20 M for all taxpayers and all taxable years. Within this overall limit, the credits certified by the IEDC must total at least \$4 M for each credit. Thus, no new credits for ethanol production can be approved under the current limits, as the IEDC certified \$12 M in ethanol production credits in 2005 (\$3 M each to four companies). In addition, the taxpayer limit for each credit is \$3 M, with provision for the IEDC to increase this limit to \$5 M for the ethanol production credit or the biodiesel production credit.

The Alternative Fuels Association (AFA) reports that one ethanol production facility currently operates in Indiana with a capacity of 102 million gallons per year. The AFA also reports that two facilities are currently under construction in Indiana, each with a 40 million gallon annual capacity. The National Biodiesel Board (NBB) reports that there are currently 45 active biodiesel production plants operating in the U.S. and 53 additional production plants proposed, including two in Indiana. The NBB reports that dedicated biodiesel plants in the U.S. have a total capacity of 60 to 80 million gallons per year, and that an additional 200 million gallons of capacity are available from non-dedicated facilities operated by oleochemical producers. The NBB also reports that a total of 59 biodiesel retailers and 41 biodiesel distributors currently operate in Indiana.

Fueling Station Investment Credits: The credit is equal to the lesser of: (1) 50% of the qualified investment; (2) \$2,000 for all taxable years for each fueling station not previously used by the taxpayer in Indiana to dispense E85 base fuel. The credit may be claimed only in the taxable year in which the fueling station property is placed in service. E85 fuel contains 85% ethanol and 15% gasoline, while B20 contains 20% biodiesel and 80% petroleum diesel. The bill requires that fueling stations eligible for the investment credit to be located at a retail outlet. The bill requires a credit recipient to pay a recapture tax to the Department of State Revenue if the fueling station property that is the basis for the credit is converted to another use within three years of the taxable year the property was placed in service. The recapture tax is equal to 75% of the credit if the conversion takes place within one year of the tax year the property was placed in service; 50% of the credit if conversion takes place within two years; and 25% if the conversion takes place within three years.

Coal Gasification Technology Investment Tax Credit: The credit may be taken against a taxpayer's tax liability arising under the AGI Tax, Financial Institutions Tax, Insurance Premiums Tax, and Utility Receipts Tax for qualified investment in an integrated coal gasification power plant. The credit is equal to 10% of the first \$500 M in qualified investment, and 5% of the qualified investment exceeding \$500 M. However, the bill would not allow the credit above \$500 M investment if the facility is not dedicated primarily to serving Indiana retail electric utility consumers. The taxpayer may take the credit in 10 annual installments beginning with the year in which the taxpayer places the integrated coal gasification power plant into service. The annual credit installment that a taxpayer may claim is equal the lesser of the percentage of the coal utilized during the taxable

year in the power plant that is Indiana coal multiplied by: (1) 10% of the total credit amount; or (2) the greater of (a) 25% of the taxpayer's total state tax liability for the taxable year or (b) the taxpayer's Utility Receipts Tax liability for the taxable year.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Property Tax Deductions:* The bill establishes assessed value (AV) deductions for "organic waste biomass conversion units" and for "coal conversion systems." The annual deduction for organic waste biomass conversion units is equal to the difference between the AV of the taxpayer's property, including the AV of the organic waste biomass conversion unit; minus the AV of the taxpayer's property, excluding the AV of the organic waste biomass conversion unit. The annual deduction for coal conversion systems is equal to 95% of the AV of the system multiplied by the proportion of the coal converted by the system during the preceding year that was Indiana coal. These deductions apply to property taxes first due and payable after December 31, 2006. Taxpayers must apply for the deduction in the same manner provided under current statute for the AV deduction for wind power devices.

Additional deductions reduce the AV tax base. This reduction causes a shift of the property tax burden from the taxpayers receiving the deductions to all taxpayers in the form of an increased tax rate. The amount of the deductions is indeterminable. Total local revenues would not be affected, except that the revenue in rate-controlled funds would be reduced.

An "organic waste biomass conversion unit" is tangible property directly used to produce gas or electricity from agricultural livestock waste nutrients or other agriculture sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop byproducts or residues. However, an organic waste biomass conversion unit does not include tangible property that uses fossil fuel that exceeds the minimum amount of fossil fuel required for any necessary startup and flame stabilization or municipal solid waste.

A "coal conversion system" means tangible property directly used to convert coal into a gaseous or liquid fuel or char, including coal liquification, gasification, pyrolysis, and a fluid bed combustion system designed for pollution control.

Hybrid Vehicle Deduction: Because the AGI deduction for owning a hybrid vehicle proposed in the bill would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

Motor Vehicle Excise Tax: Revenues from the tax are allocated to the taxing district in which the registrant resides. Allocations could be affected in districts where E85 passenger cars and trucks are registered.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation; Department of Local Government Finance; State Fair; State Forestry. Indiana Utility Regulatory Commission. Indiana Department of Transportation.

Local Agencies Affected: All. Counties with a local option income tax.

Information Sources: Hybrid registrations data and median vehicle age estimates from R. L. Polk & Company at <http://www.polk.com>. Hybrid sales forecast from Office for the Study of Automotive Transportation, Transportation Research Institute, University of Michigan. *Estimates of Federal Tax Expenditures for Fiscal*

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